Transnationals

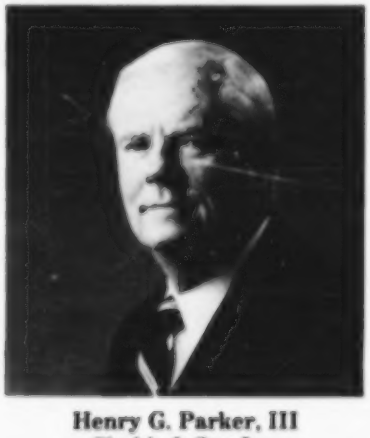
Annual Meeting . . .

GROWTH IN INVESTMENTS TO DEVELOPING COUNTRIES HIGHLIGHTED

With so many countries opening to foreign capital, technical assistance, research, and information services are of the utmost priority for the United Nations, according to the United Nations Commission on Transnational Corporations which met in New York from 5-15 April 1993. It noted, in particular, the recent increase in investment flows to developing countries.

In 1991, despite a world economic slow-down and a drop in inflows to developed countries, investments to developing countries jumped to $36 billion, partly as a result of economic revival in Latin America and liberalized investment legislation in a number of Asian countries. Further, the opening of Eastern and Central Europe has not diverted investment away from developing countries, as many had feared. In fact, investments to developing countries grew by 20 per cent in 1991.

Ibrahim F.I. Shihata, Vice President and General Counsel, The World Bank.



Henry G. Parker, III Chubb & Son Inc.

Ibrahim Shihata of the World Bank presented to the Commission the Bank's new guidelines on foreign direct investment. The Commission also heard the views of a number of experts on how it might enhance its contribution to development. Michael Hershman of Transparency International, a coalition against corruption in international business, underlined the need for international anti-corruption legislation. Corruption, he said, could drive up the cost of business by 30 to 40 per cent and undercut economic development. Henry Parker of Chubb and Son Inc. suggested that investment and technology flows to developing countries might grow if international insurance were deregulated and its rules harmonized. ■

UN Strengthens Trade-Investment Link

On 1 July 1993, the United Nations integrated its New York-based programmes on foreign direct investment and technology and transferred responsibility for them to the United Nations Conference on Trade and Development (UNCTAD), Geneva. The move to Geneva is scheduled for September 1993.

The merger is a response to the strengthening links between global flows of trade, technology, investment and finance. A growing share of global trade is now effected by or within transnational corporations, which also generate most new technology and play a central role in the international transfer of know-how, skills and capital.

The integration in UNCTAD of activities related to trade, finance, investment and technology is expected to create synergies that will strengthen United Nations work in these areas. ■

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Privatization Fuels Investments

Privatization has caused foreign direct investment to burgeon in many developing and formerly centrally-planned economies. With over 80 countries undertaking privatization programmes, some $185 billion in state-owned assets worldwide, or some 8,500 enterprises, have been put up for sale, 2,000 of them in developing countries.

The level of foreign direct investment in privatization differs from country to country, but the amount of inflow can be significant. In Jamaica, privatization accounted for 94 per cent of all inflows in 1987. In Czechoslovakia, Volkswagen paid $6.1 billion for the Skoda car company. In Argentina, in the largest privatization in Latin America, investors paid $3 billion for shares in the national petroleum company, Yacimientos Petroliferos Fiscales.

Privatized assets are often of great interest to transnational companies. They provide one more asset in international strategies,

Management or lease contracts for state-owned enterprises are becoming popular.

offering ready-made markets in which there are few competitors. In addition, they are frequently for sale at a considerable discount.

Promoting Local Participation

Governments have welcomed foreign investment in privatization.

Nonetheless, many countries are striving to ensure that foreign direct investment does not crowd out local private-sector participation in privatization. Some have restricted foreign ownership in privatized assets. Others have set limits on what individual investors may hold to ensure that none is dominant.

Governments usually try to divest smaller enterprises first, to enable domestic investors to establish a foothold. Governments may also foster spin-off local businesses. Local firms, for instance, can be commissioned to conduct repair, installation, and other services in a divested telecommunications enterprise.

Maximizing Economic Returns

Privatizations need to be conducted in a way that puts state assets to the best economic use. That implies a pre-competitive sectoral framework or, absent competition, a well-structured regulatory system. Macroeconomic reform is complementary, as is the careful monitoring of post-privatization developments.

Once the commercial parameters of a privatization transaction are set, governments should ensure that the sales process maximizes the price of the interests of which it is disposing. Enterprise value should be based not only on historical cost but on likely future earnings, incorporating the investors' assessment of political and economic risk.

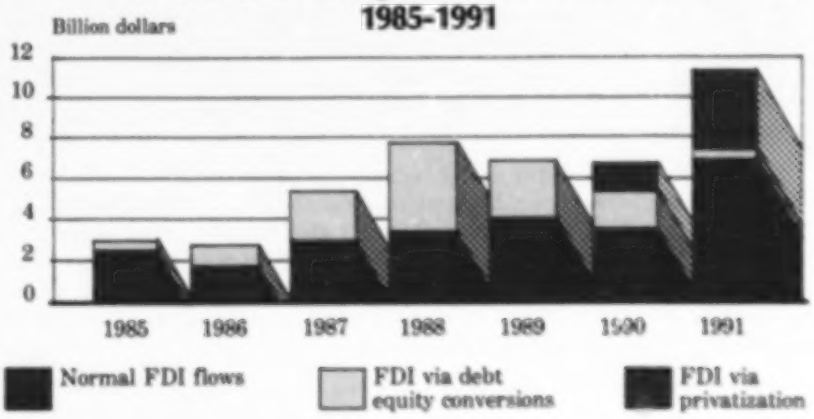
Future Trends

New forms of privatization, such as management or lease contracts for state-owned assets, are becoming popular. Under build-operate-transfer agreements (BOTs) investors may put up public utilities and manage them until they recover their costs. Or they may be subcontractors providing public services on behalf of the state.

So far, foreign participation in privatization has concentrated in the manufacturing and utilities sectors, particularly telecommunications. In the coming years, foreign investors are likely to focus on mining and petroleum, primarily through joint ventures with state-owned mining and petroleum enterprises. They are also likely to lease a growing number of state utility and infrastructure assets.

The Programme on Transnational Corporations is assisting some 20 countries in the process of privatization. Assistance ranges from asset valuation and structuring divestment to promoting local participation. ■

Latin America: Foreign Direct Investment Flows, 1985-1991

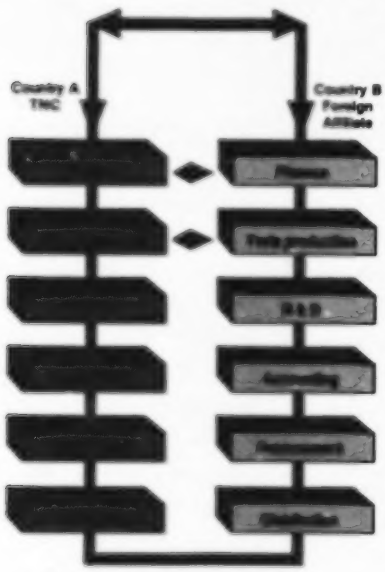


READEX FICHE

Transnationals Creating Global Production System

In seeking to outdo each other in world markets, transnational companies are underwriting an integrated system of international production. The world economy is being transformed into one in which transnational affiliates in various countries contribute to producing goods and services which are then marketed globally. Already, says the just-released *World Investment Report 1993: Transnational Corporations and Integrated International Production*, some one third of world private-sector production is under the governance of global firms whose activities are integrated to varying degrees.

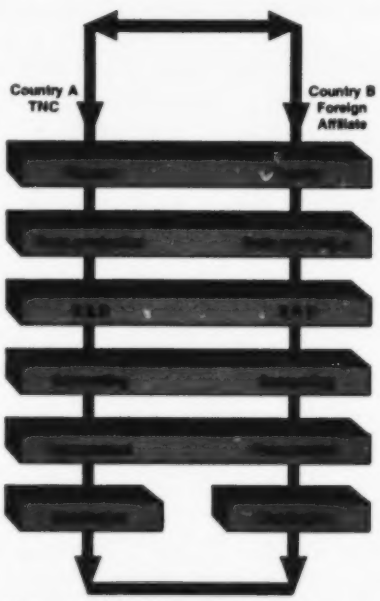
Stand-Alone Strategy



Common governance exercised over a few corporate functions.

Transnational companies are dividing the production process and dispersing it throughout the world. Ford's new car, Mondeo, for example, has been designed in Germany and the United Kingdom, uses engines and car parts from the United States, Europe and Thailand, and is manufactured in Belgium and the United States. The reason: competition is forcing firms to seek cost savings and profits from all segments of their activities. New telecommunications and information technologies allow firms to allocate tasks to the most efficient affiliates, subcontractors and suppliers throughout the world. At the same time, converging consumer tastes and liberalized governmental regulations enable firms to operate in a global manner.

Integrated Production



Common governance exercised over many corporate functions in an integrated manner.

Integration is proceeding at different rates across industries and functions. It has advanced most rapidly in automobiles, electronics and air transport. Research and development are becoming increasingly interlinked across borders, both within firms and through external strategic alliances. Financial management is probably the most global of the major corporate functions.

From Simple to Complex Integration: Strategies and Structures

National economies are being knitted together through a dense network of cooperative relationships within and between firms. As a result, the world economy is slowly moving into a state of "deep" integration, where trade, investment and subcontracting link more and more countries together.

An increasing share of global trade and technology now flows within and between transnational corporations, through intra-firm and interfirm transactions. Companies have begun to organize production and distribution globally, creating a world-wide intra-firm division of labour. Individual affiliates are beginning to perform specific functions for the company as a whole or in close interaction with other affiliates. The United States company, AT&T, for instance, has put its French affiliate in charge of its world-wide corded telephone business. Another United States firm, DuPont, manages its electronics business from Japan, and its agricultural, polymer and fibre products from Switzerland.

> ***A United States firm manages its electronics business from Japan and its agricultural products from Switzerland.***

At the same time, firms have

(Continued on page 4)

Global Production

(Continued from page 3)

been subcontracting parts of the production process out to host-country or third-country firms and buying components and inputs form suppliers all over the world. Cross-border corporate alliances are proliferating to develop new technologies and expand markets. More technological innovations are being generated in host countries.

Global production is also being organized to exploit time differences and allow a 24-hour working day. At the end of its day, a North American company may, for instance, transfer key tasks to an East Asian affiliate that is just starting its day.

Linked by contributions to a single value-added chain, parent firms, affiliates, foreign suppliers, and subcontractors are now becoming more interdependent. With an estimated 37,000 transnationals world-wide, the forces propelling deep integration are considerable.

Deep integration builds on the "shallow integration" effected by international trade. Trade established the first cross-border link between countries. Transnational companies strengthened those links by setting up foreign affiliates, which tended to be self-contained, undertaking production entirely in-house and catering to one or two host markets. Generally, such "stand-alone" affiliates had little operational tie-in with their parents or with local firms. Production links between countries were weak.

As more and more countries opened to foreign direct investment, firms were able to establish footholds in new markets. Aided by technological advances, they expanded the geographic scope of their activities and, as described earlier, began to enter complex production relationships with a host of new partners.

Integrated Production May Reshape Trade

Foreign direct investment is forging stronger functional links than trade. It is also establishing more extensive geographical ties since investors often go wider afield than traders. Japan, for example, trades primarily with East Asia and the United States.

Integrated production could further globalize trade.

However, it has strong investment links with Peru. Similarly, while the United Kingdom trades primarily with Europe, it invests a good deal in Kenya and Ghana.

Integrated international production, involving substantial intra-firm flows of goods, services, and capital, could further globalize international trade, strengthening intra-regional as well as inter-regional economic integration. ■

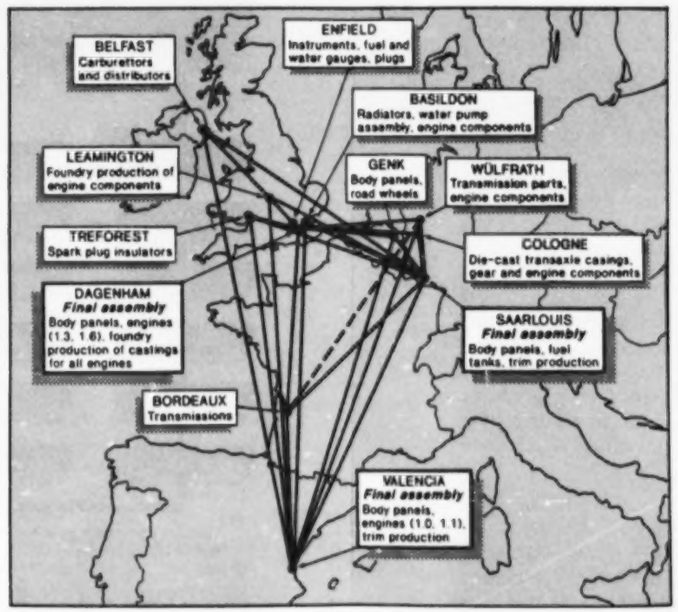
Trade established cross-border links, which transnational corporations strengthened by setting up stand-alone affiliates. Now, complex production relationships are propelling deeper integration.

Integrated Production Intensifies Governance Concerns

By reshaping the hierarchies within transnational corporations, globalized international production is undermining the applicability of corporate laws in such areas as parent-affiliate liability and cross-border taxation. While scholars and policy-makers have been seeking alternatives for some years, globalization makes their task more necessary.

Parent-Affiliate Relations Are Increasingly Complex

Ford's Production Network in Western Europe



New Hierarchies

In a departure from earlier "stand-alone" strategies, affiliates are working side by side with parent firms and with one another to carry out global production. Capital, technology and skills flow back and forth between parents, affiliates and unrelated firms. Parents and affiliates are sharing decision-making and managerial authority. Affiliates, not just the parent firm, may sometimes be the source of a firm's overall competitiveness.

Parent firms are devolving control to regional, product or functional headquarters charged, respectively, with responsibility for a geographical area, a line of business, or a management function. The Singapore-based regional headquarters of the Japanese NEC Corporation, for example, is responsible for providing research and development support to all affiliates in the ASEAN region. Within a transnational, then, different offices may be responsible for different parts of the global operation.

Corporate ownership is also becoming more diffuse. More companies are raising equity in international capital markets. As a result, a single firm may have stockholders in several countries.

It is harder to discern lines of control, and where income is earned and distributed.

The ten largest transnationals, for instance, list their stock in over 70 countries. Layers of ownership are also emerging, with existing affiliates setting up their own affiliates. Given the multitude of tiers, reporting and control relationships may not be linear. United States affiliates had an average of 2.4 tiers of ownership in 1991.

Also blurring corporate boundaries are strategic alliances in which firms share control over a specific project or activity and often cross-hold shares.

Parent Versus Affiliate Liability

Burgeoning corporate linkages and an ever more complex intra-firm division of labour make it difficult to determine the relative duties of parents and affiliates. Under existing law, each affiliate

(Continued on page 6)

Promotion Should Target Corporate Process or Function

As globalized production re-engineers the transnational firm, investment promotion may gain from a different emphasis.

Final production in foreign markets is waning as the focus of foreign direct investment. Companies are searching for the cheapest, most efficient location to perform specific production processes or corporate functions. Rather than seeking to attract an entire corporate package, prospective host countries may find it more useful to target parts of the production process and strengthen the national capacity around it. Examples of such functions are product and process innovation, accounting, or research and development. Ireland, for instance, has concentrated on providing information-intensive services to draw considerable new investment. India has recently attracted a number of transnational affiliates by carving a niche in software programming.

More developed countries might also develop themselves as prospective headquarters for a product, a region or a function. Such headquarters often involve a high level of managerial skill and expertise and can have spillover effects on the local economy.

Singapore has become headquarters for many transnationals with activities in Asia and the Pacific. It has readjusted policies on resource and credit availability, infrastructure and human resource upgrading. It also offers a wide spectrum of services and incentives to transnationals. State-of-the-art telecommunications technology allows transnationals to trade in financial centres throughout the world. Singapore's location in a time zone that overlaps with the working hours of both European and Asian financial markets is another advantage.

Integrated Production

(Continued from page 5)

is treated as a separate entity, with its own rights and obligations. However, such a standard does not reflect the functional ties between affiliates as a business group or the way responsibility is allocated between them. Neither does it reflect the geographic dispersion or layering of corporate ownership, or the emergence of networks, with their multiplicity of intra- and interfirm linkages.

Taxation

International taxation is more complicated. It is now harder to identify separate costs and earnings for individual transactions, or to ascertain where taxable income is earned, how it is distributed, and how revenues are allocated among different countries.

Governments are experimenting with different approaches to preserve their revenue base and maintain climates conducive to transnational corporations. Such a balancing act is difficult and may well require substantial thought.

Nationality

Under current law, firms are nationals of the state where they are incorporated. But with parents and affiliates each having assets and operations in several countries, it is difficult to ascertain corporate nationality, a concept that is important in governing firms and providing them with governmental protection. Thus new concepts are needed, but have yet to evolve. ■

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Insurance Transnationals Opt for Client Contact

In many service industries, the spread of telecommunications and information technologies could lead to a decrease in the number of overseas affiliates. By enabling firms to provide services to foreign clients electronically—or making services tradeable—those technologies eliminate the need for a corporate presence abroad.

But, according to a recent study, information technologies do not seem to have affected significantly

With 12,000 firms, the insurance industry is valued at over $1 trillion.

the way business is conducted in the international insurance industry. There are now some 12,000 insurance firms world-wide, and the industry, measured in total paid premiums, is valued at over $1.36 trillion. In the last fifteen years, nearly all of the world's large insurance firms have increased the number of their affiliates overseas. Of the top thirty firms, two have more than 100 affiliates; six have over 50.

The use of information technology in the industry has increased rapidly. However, rather than using information technology to increase the cross-border electronic delivery of services, insurance firms have been focusing on improving the efficiency of existing structures.

Face-to-face contact with clients is vital in selling and customizing insurance packages. The degree of contact required varies with the type of insurance. Life insurance, for instance, requires close control over the appraisal of client risk, the

underwriting policy, and the settlement of subsequent claims. Marine and aviation insurance, on the other hand, or reinsurance, in which insurers insure other insurers, seldom requires firms to meet clients or appraise risk directly.

Those differences, in turn, affect the form of foreign investments. Where proximity is essential, firms prefer wholly-owned subsidiaries or representative offices. In other cases, they use joint ventures, locally managed associates, reinsurance, or local intermediaries.

European Firms are Most Transnationalized

European insurance firms have more affiliates abroad than United States or Japanese firms, although the latter are much larger. A few European companies are beginning to use cross-border trade and marketing links to deliver insurance services to foreign markets.

Reinsurance Holds Scope for Change

Reinsurance presents the greatest potential for the development of cross-border trade. It is the fastest-growing and the most internationalized of the three main categories of insurance: life, non-life, and reinsurance. Some 40 per cent of world reinsurance was supplied by foreign affiliates in 1983.

While many countries restrict foreign direct investment in life and non-life insurance, reinsurance has been fairly unfettered. Local insurers frequently obtain external reinsurance. Moreover, international reinsurance involves a complex network of intercompany relationships based on sophisticated information technologies: the basis for cross-border trade.

Developing Countries Potential Catalysts

Developed countries account for nine tenths of the global insurance market. But developing countries are likely to provide the impetus for cross-border trade in insurance, the study says. Over the 1980s, the insurance market in Asia quintupled, and, in Africa it tripled. Continued increases in income will boost the demand for insurance services. Besides, many Asian countries have well-developed informatics industries and are well placed to forge international trading and licensing links in the delivery of insurance services.

The study, *International Tradeability in Insurance Services: Implications for Foreign Direct Investment in Insurance Services* (Sales No. E.93.II.A.11), is part of a series examining the impact of information technologies on the way services are delivered to foreign markets. ■

The World's Fifty Largest Insurers

(Ranked by total assets)

1. Nippon Life
2. Prudential Insurance
3. Zenkyoren
4. Dai-ichi Mutual Life
5. Sumitomo Life
6. Allianz Holding
7. Metropolitan Life
8. Union des Assurances de Paris
9. Aetna Life and Casualty
10. Meiji Mutual Life
11. Prudential
12. Asahi Mutual Life
13. American International
14. Cigna
15. State Farm
16. Internationale Nederlanden
17. Tokio Marine and Fire
18. Assurances Generales de France
19. Equitable Life
20. Mitsui Mutual Life
21. Teachers Insurance
22. New York Life
23. Travelers Corporation
24. Australian Mutual
25. Zurick Insurance
26. Assicurazional Generali
27. Allstate
28. Standard Life
29. Yasuda Mutual Life
30. Norwich Union
31. Aegon
32. Yasuda Fire and Marine
33. John Hancock Mutual Life
34. Legal and General
35. American General
36. Northwest Mutual
37. Winterthur Group
38. CNA Financial
39. Commerical Union
40. Lincoln National
41. Transamerica
42. Nationwide Insurance
43. Swiss Life Insurance
44. Principal Mutual Life
45. Royal Insurance Holdings
46. Sun Life Assurance Co.
47. Swiss Reinsurance
48. MassMutual
49. Mitsui Marine and Fire
50. Sun Alliance Group

Total World Insurance Business by Region, 1980 and 1990

(Percentages)

Region	1980	1990
North America	46.9	37.9
Europe	32.6	33.9
Asia	15.6	24.6
Africa	1.2	1.1
Central and South America	2.0	0.7
Oceania	1.8	1.8
Total Premiums	$431.5 billion	$1,355.7 billion

Developing Country Transnationals Bring Home Benefits

Transnationals from developing countries control some $110 billion in foreign direct investments, or 8 per cent of global investment stock in 1990. Hong Kong invests more abroad than Belgium, Denmark or Norway. Taiwan Province of China and the Republic of Korea invest more than they received. Singapore, China, Argentina, Brazil, Colombia, India, Mexico, Pakistan and Venezuela are other significant capital exporters among developing countries.

A new study, *Transnational Corporations from Developing Countries: Impact on their Home Countries*, examines, for the first time, the effects of such investments on economic growth in home developing countries. It asks particularly whether the foreign operations of developing-country transnationals tap new skills and technologies, promote exports, and encourage industrial restructuring and upgrading at home.

In general, the answer is yes. Over half of all developing country investments are now located in developed countries. Many are market-seeking. Technology acquisition is also a prime motive, especially for firms from countries with restrictive technology import policies, or for high-tech firms seeking new innovations and opportunities. The United States is the largest host, followed by the Netherlands, the United Kingdom, France and Germany.

Largest Recipients of Developing Country Investments
(Stock, billions of dollars, 1990)

United States	26.7
Indonesia	11.7
China	10
The Netherlands	7
United Kingdom	6.5
Australia	3.9
France	3.7
Germany	3

Enhanced Competitiveness

Investing abroad has pushed developing-country firms to restructure and rationalize their operations. In some cases, domestic profitability has increased because of greater vertical or horizontal integration, portfolio diversification, the spread of fixed costs, and reductions in tax liabilities. Foreign investments seem more likely to stimulate exports than to displace them. Often they even contribute to promoting inward FDI.

The domestic employment effects of foreign investments are more ambiguous. They do not necessarily create jobs at home. But, through their presence in foreign markets, developing-country transnationals can create competitive advantages for their home countries. What those are will depend largely on home-country policies.

From the study, it seems that countries with outward-looking trade strategies and strong domestic competition policies have benefited the most. In addition, the study suggests that developing countries should do their best to strengthen the competitiveness of their transnationals by improving national education and infrastructure, providing support to science and technology, and employing appropriate technology import policies. ■

Transnational Corporations from Developing Countries: Impact on their Home Countries (Sales No. E.93.II.A.8) is available from the United Nations Sales Section, New York or Geneva.

The Programme on Transnational Corporations is carried out by the United Nations Conference on Trade and Development under the guidance of the Commission on Transnational Corporations, an intergovernmental subsidiary organ of the United Nations Economic and Social Council. The Programme seeks to further understanding of the nature of transnational corporations; to secure effective international agreements; and to strengthen the negotiating capacity of host countries, particularly the developing countries.

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